The Investment Podcast

M&G Investments

Episode 22: The Investment Podcast: What next after the summer rally in bonds and equities?
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Speaker 1: *The Investment Podcast*, brought to you by M&G.

Speaker 2: This podcast is for investment professionals only.

Romil Patel: Hello and welcome to this episode of *The Investment Podcast*. My name is Romil Patel, and joining me today is Fabiana Fedeli, Chief Investment Officer for Equities and Multi Asset at M&G Investments. Hi, Fabiana, it's a great pleasure to welcome you onto *The Investment Podcast* today.

Fabiana Fedeli: Hi, Romil. Hi, everyone, thank you very much for having me.

Romil: Fabiana, it's been a bruising year, to say the least, with inflation at a 40-year high, a steady rise in interest rates by central banks globally, an increased risk of recession and the worst first half on record for global equities. Adding to that mix, any flare-up in geopolitical tensions has the potential to add further difficulties to what are very real everyday issues such as the cost of living as we approach the winter months. How are you making sense of all of this and, indeed, adjusting the investment sales?

Fabiana: As you've said, Romil, there are many inputs at the moment that are coming from different directions and are influencing markets, both fixed income and equities. Because there are a lot of uncertainties on how many of these elements will eventually conclude, this is just not a market for broad macro calls. Right now, big sweeping bets are extremely risky. The way we're looking at the market is we're being very tactical, and we're being very selective.

Now, the good news is that the volatility that we're seeing in markets, you've seen a steep decline, then it bounced, then another decline and a small bounce and decline, the volatility is actually providing us with significant idiosyncratic opportunities because when there is a big market movement, it often takes with it also companies where that kind of price action is unwarranted.

What we've been doing, really, we're being from a multi-asset standpoint, after the summer rally, both in bonds and in equities, we have cut our position in equities, we have taken some profit, moved down back to a neutral position, and we've also increased our position on duration being short. It's been an increase of a short duration position at the shorter end of the curve and a more balanced neutral position at the longer end of the curve, so overall, a still short duration position, but we do recognise that the shorter end of the curve will be affected more by central banks continuing to increase rates, we see that to continue.

At the same time, we believe that the longer end of the curve, particularly the US 30-years, will most likely reflect investors' concerns on growth and could therefore be far more stable than the shorter end of the curve. On the more idiosyncratic level, for example, in equities versus convertible or corporate bonds, we've started to move a little bit more from equities to corporate bonds, where we see a relative value coming up in corporate bonds rather than equities but overall, quite a subdued and, as I said earlier, neutral position.

We're actually quite high in our cash positions. Within equities, we're really taking advantage of any market drops where we find that there are names that have a significant, strong fundamental outlook that has been, if you want, heard in a warranted way by the price action, areas such as, for example, technology-especially-facing enterprises, the cloud, data. There's significant opportunity there.

Romil: That's rather interesting, Fabiana, because you mentioned valuations, and the FTSE 100 is still at a multi-decade low in terms of valuations versus other major world indices. Does that throw up opportunities?

Fabiana: It is very interesting because we are very concerned about macro in the UK. We're very concerned also about the potential for a rise in debt levels and, obviously, also the fact that there is a significant portion of the UK overall government debt, which is linked to inflation and that, obviously, it is affected by the inflationary pressure. However, the FTSE 100 is an index that, by and large, is very much outward-orientated.

About 75% of the revenues of the FTSE 100 are in currencies other than the British pound. It will, in our opinion, benefit from any potential, first and foremost, currency decline, which is not unlikely in the pound, and at the same time, it is at the valuation that is about a multi-decade low. We do like the market. Again, it is a very stock-idiosyncratic exercise. We do like some of the largest names in the FTSE 100, but we are very cautious about the overall macro backdrop in the country.

Romil: Indeed. Well, let's turn our attention to inflation, which has been the dominant story, so far, of this year. If we've learned anything, following the two most recent 75 basis point rate hikes from both the US Federal Reserve (Fed) and the European Central Bank (ECB), it's that despite the risk to growth, central banks do remain committed to taming inflation. After a period of dislocation over the summer months between market expectations and central bank actions, the question for investors is, are asset prices now effectively reflecting a tighter pace of monetary tightening, or could we still see further falls from here?

Fabiana: That is a key question. The way we're looking at markets at the moment is we still see, on the fixed income side, on the shorter end of the curve, some weakness, obviously driven by rate hikes, more stability at the longer end of the curve, particularly in the US, given that it's viewed by investors as insurance for a negative growth potentially ahead.

We're quite cautious, in general, also on the corporate bond market, although we do admit that valuations have improved and there are opportunities there. When it comes to the equity market, We're going to be in a market that is very much driven by news flow. We do feel that in the end, the appropriate valuation of the market will probably be closer to the lows that we witnessed in June. That boundary, those June lows, really, would reflect a mild recession, a slowdown in the global economy, which obviously will be different according to regions.

It would not reflect a credit crisis-type of scenario. We don't forecast, we don't foresee that kind of scenario. We are in a much stronger, if you want, credit backdrop. Banks, financial institutions are much better capitalised. We're just not at that point, but should that point ever come up at the horizon, then the equity market could definitely challenge those lows that we have seen, and we could see, obviously, more stress also on the corporate bond market.

On the other end, there's always a possibility that the war in Ukraine comes to a conclusion. The key there is not a conclusion of the war, per se, but is a conclusion that would allow the removal of those sanctions on hydrocarbons. That, obviously, would be a very strong boost for markets. Again, it's very difficult to foresee that that could happen, first and foremost, any time soon; secondly, in any clear fashion whereby sanctions would be simply removed.

But the key here is how you invest in a market like this, right, because say that putting money in equity markets is going to give you a real nominal return of zero. Well, you have an inflationary pressure, so you have to take into account also that inflation and your real return will obviously become negative. The way we are really looking at it is that we need to make our capital work.

Just sitting in a market that, yes, it's down about anywhere between 20% and 25%, depending on regions and countries and currencies across the world, thinking that, well, over the next quarter, it can't go down much longer is probably not going to allow you a return that's going to beat that inflation rate, but if you are an active investor and you're taking advantage of some of the volatility and the dislocation that we're seeing among different securities in the market, both at the corporate bond level but also at the equity level, I think there, there is a lot of opportunity to actually make a good return.

Romil: Of course, Fabiana, as active investors, it's important to do this within the context of sustainability. I think it would be interesting to touch on ESG, which has evolved hugely over the last few years from what was a pure risk mitigation tool to producing and measuring real-world impact, particularly in the context of the things that we see today. I thought it would be interesting to ask you how we are aligning our own ESG priorities with the types of sustainability requirements large asset owners are demanding in what is an ever-changing world and what some of your top priorities may be.

Fabiana: Sustainability is here to stay. I actually personally believe that five years from now, we will not talk about sustainability anymore because it will be so mainstream that it will be just part of what we do on a regular basis.

At M&G, we very much support and believe in the changes that the whole world, not only the market, is making from a sustainability standpoint, from a climate standpoint.

We continue to improve our resources, our skill set, our know-how in this area. In the end, what is important to us is that we can walk with our clients. It's really a path, and it's still a journey, and it's still right there happening. We need to be able to support our clients throughout this. There is, obviously, new regulation. There are also values and societal pressures that are important to us and to our clients.

We continue to invest. We're investing, for example, in improving the quality of our sustainability data, our ability to improve our climate scenario analysis. We're trying to stay ahead of what we believe will be also regulatory changes that our clients will have to deal with, and we need to be there, able to support them.

Romil: Thanks, indeed, Fabiana. Well, unfortunately, that's all we have time for in today's instalment of *The Investment Podcast*. We hope you enjoy today's show. Fabiana, it's been an absolute joy to share the mic with you today. Thanks, indeed, for sharing your expertise with us.

Fabiana: Thank you, Romil, and thank you to everyone in the audience. It has been an absolute pleasure.

Romil: Indeed. Well, we also look forward to seeing our audience next time and, hopefully, you, too, Fabiana, for another instalment of *The Investment Podcast*. Unfortunately, it's goodbye for now. Hopefully, see you next time.

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Speaker 2: For further information, please view the notes which accompany this episode. This podcast is for investment professionals only. The value of investments will fluctuate, which will cause prices to fall as well as rise, and investors may not get back the original amount they invested. Past performance is not a guide to future performance. The information and views expressed should not be taken as a recommendation, advice or forecast.

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